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Assessing the Performance of African Tax Administrations: A Malawian Puzzle

Waziona Ligomeka

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The ICTD's African Tax Administration Papers (ATAPs) are research papers that will be of specific interest to people working in tax administration in Africa. The purpose is to encourage and support useful, policy-oriented research by African professionals directly involved in tax administration.

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Assessing the Performance of African Tax Administrations: A Malawian Puzzle

Waziona Ligomeka

Summary

We lack good indicators of the quality of national tax administrations, especially for low-income countries. The situation is, however, improving. Through the relatively new TADAT process (Tax Administration Diagnostic Assessment Tool), an increasing number of national tax administrations are receiving scores from teams of peer reviewers on how well they perform in nine key functions. That scoring process is intended primarily to serve management purposes, i.e. to indicate areas for potential performance improvement. But the TADAT scores are, inevitably, widely viewed as performance rankings. A revenue administration with a higher average TADAT score will be viewed as 'better' than one with a lower score. But how accurate are these implicit rankings? An analysis of the case of the Malawi Revenue Authority raises important questions about both the rankings and the broader question of how to identify good tax administration. The authority's TADAT scores are very low. But its actual revenue collection performance is relatively good: compared to other countries in sub-Saharan Africa, it collects a relatively high proportion of GDP in tax, and is particularly successful in collecting direct taxes, especially from larger companies. A very high proportion of revenues are collected by the small Large Taxpayers Unit. Yet the unit uses only very basic digital technology to keep records on those companies. This is a puzzle. The likely explanation is that a small number of staff successfully monitor larger companies for revenue collection purposes using relatively informal, low-tech methods. There are two broader implications. One is that performance can vary considerably between different parts of the same organisation, and performance indicators intended to apply to the organisation as a whole may be misleading. The other is that we still have some way to go in both understanding and measuring the factors that lead to good tax administration.

Keywords: Malawi Revenue Authority, tax administration, taxation, TADAT, large taxpayer unit, organisational performance.

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Acronyms

CG	Commissioner General
CIT	Corporate income tax
EFD	Electronic Fiscal Device
GDP	Gross domestic product
LTU	Large Taxpayer Unit
MK	Malawi Kwacha
MRA	Malawi Revenue Authority
OECD	Organisation for Economic Co-operation and Development
PIT	Personal income tax
POA	Performance outcome area
SACS	Surtax Administration Computer System
SAS1	Self-assessment System - 1
SAS2	Centralised Self-assessment System - 2
SSA	Sub-Saharan Africa
TACS	Tax Administration Computer System
TADAT	Tax Administration Diagnostic Assessment Tool
TIN	Taxpayer identification number
VAT	Value added tax
WHT	Withholding tax

Introduction

An efficient and effective tax administration is important for a country if it is to raise significant revenues for smooth running of the country. But how do we know the quality of a tax administration? This question becomes important especially for low-income countries as they lack good indicators of the quality of national tax administrations. This study evaluates the efficiency and effectiveness of the Malawi Revenue Authority (MRA) in undertaking some functions. The MRA is an interesting case study because, when judged by the standard criteria for effective tax administration, as carried out under the Tax Administration Diagnostic Assessment Tool (TADAT),[1] the MRA appears to perform very poorly, even by the standards of low-income countries (TADAT Secretariat 2015). As will be noted in the next section, these observations are in conflict with the facts that the MRA (a) is rather effective at capturing a relatively high proportion of gross domestic product (GDP) in tax (above the average for sub-Saharan African (SSA) countries every year since 2009), and (b) collects a high proportion of that through what is normally seen as a very challenging channel, i.e. direct taxes on corporate profits (corporate income tax – CIT) and on employment income (personal income tax – PIT). This paper aims at exploring this puzzle in detail. Specifically, I attempt to answer the question: to what extent do the tax administration processes followed by the MRA affect the level of tax revenue collection and the structure of the tax system in Malawi? I explore this issue by examining the MRA's performance in four out of the nine areas assessed under the TADAT, namely:

1. Taxpayer registration and data management;
2. Detection and prosecution of tax fraud through tax audit;
3. Handling of administrative appeals and complaints through a dispute resolution process; and
4. Provision of services and assistance to taxpayers through taxpayer education.

The analysis is based on qualitative data collected through semi-structured interviews conducted with MRA officials, analysis of MRA documents (such as annual reports, strategic frameworks, and management reports), and the TADAT report for Malawi.

The main finding of the study is that the apparent paradox – the poor performance of the MRA even by the standards of low-income countries on one side, and the institution's effectiveness at capturing a relatively high proportion of GDP in tax and the collection of a high proportion of direct taxes through CIT and PIT on the other – is largely explained by the relative efficiency of the Large Taxpayer Unit (LTU). The LTU is responsible for managing only 2 per cent of total taxpayers yet collects over 70 per cent of domestic tax revenues. However, the LTU itself is not well-equipped from a technological perspective. It relies heavily on some very basic software for recording taxpayer information. Nevertheless, the LTU staff interact closely with the staff of large companies and understand their clients' businesses well. This has enabled the LTU to effectively and efficiently tax large companies, and that in turn has resulted in a good overall revenue collection performance.

The paper contributes to the debate on tax revenue mobilisation in SSA by providing comprehensive evidence from Malawi on how a low-income country with a pattern of tax administration that appears to be ineffective by normal measures, is effective in practice. Furthermore, the main finding from this paper has two broader implications. One is that performance can vary considerably between different parts of the same organisation, and

[1] The Tax Administration Diagnostic Assessment Tool (TADAT) has been developed by international development partners, with technical input from a wide range of experts. It is designed to provide an objective, standardised, evidence-based, quality-assured assessment of a country's tax administration system, helping to make these systems fairer and more efficient. http://www.tadat.org/

performance indicators intended to apply to the organisation as a whole may be misleading. The other is that we still have some way to go in both understanding and measuring the factors that lead to good tax administration

The remainder of this paper is organised as follows. Section 1 is an overview of tax collection in Malawi and other countries in SSA. Section 2 is a literature review of evaluation of tax administration performance focusing on TADAT, the main tool being used to evaluate tax administration performance in low-income countries. Section 3 covers the methodology and Section 4 is an analysis of the study's findings. Section 5 concludes.

1 Tax revenue performance in Malawi and other countries in sub-Saharan Africa

1.1 Tax structure

Taxes are conventionally divided into two categories: direct tax, a tax which is levied on the income or profits of the person who pays it, rather than on goods or services; and indirect tax, a tax on goods and services collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (Obwona and Muwonge 2002). In Malawi, the major direct taxes are corporate income tax and personal income tax. Other direct taxes in Malawi include withholding tax (WHT),[2] rental income tax, tax on interest from banks, and turnover (presumptive) tax.[3] The major indirect taxes in Malawi are value added tax (VAT), excise taxes (which are applied to selected items such as alcohol, cigarettes, and motor vehicles) and taxes on international trade transactions (i.e. import duty, import VAT, and import excise duties).

In general, low-income and middle-income countries rely more on indirect taxes than direct taxes, compared to high-income or Organisation for Economic Co-operation and Development (OECD) countries, which have a balanced reliance on direct and indirect taxes. The literature suggests that the main reasons for low-income countries having low reliance on direct taxes are as follows:

1. In low-income countries, agriculture contributes a large share of GDP, and industry and manufacturing only a small share (Morrissey, Von Haldenwang, Von Schiller, Ivanyna and Bordon 2016). The larger agricultural sector reduces taxable capacity, as agriculture is mainly a subsistence activity in low-income countries and is difficult to tax directly. On the other hand, a large industrial sector is easier to monitor and tax, and a larger share of manufacturing in GDP indicates economic development and a larger formal (taxable) sector. Thus, a low-income country with a high reliance on direct tax indicates that the tax administration is able to collect more direct taxes from a small-industry sector, i.e. the manufacturing sector, or the agricultural sector.

2. Low-income countries have low per capita income. Accordingly, income tax collection is low because the income tax base is small (ATAF 2018).

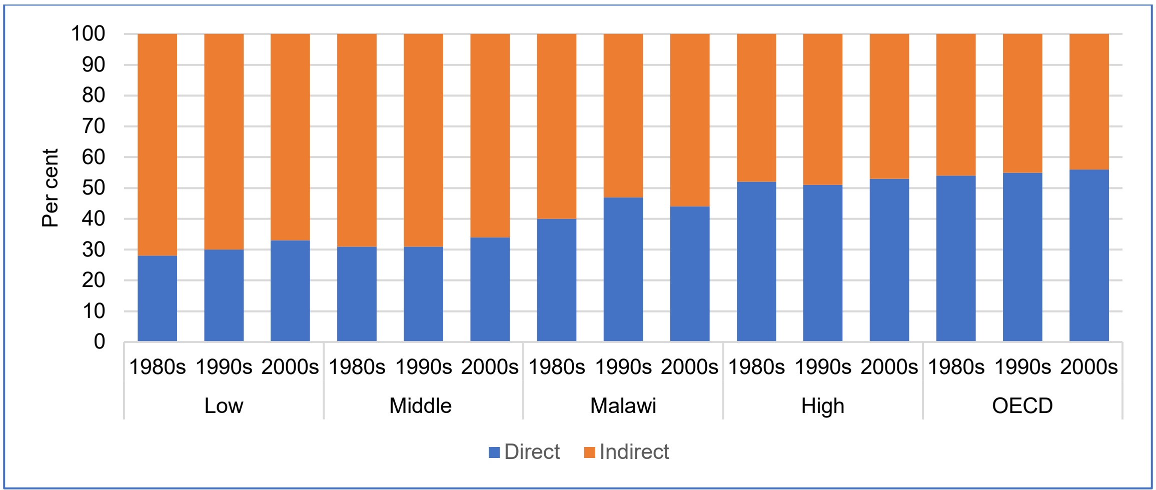
3. There are a number of administrative challenges that hinder the effective enforcement

2 A withholding tax (WHT) is an income tax to be paid to the government by the payer of the income rather than the recipient of the income. The tax is thus withheld or deducted from the income due to the recipient.

3 This refers to the income tax paid by businesses whose annual turnover is less than MK10 million (US$13,516) in Malawi. The turnover tax rate is 2 per cent of gross income while the standard income tax rate for businesses is 30 per cent of profits.

and collection of income taxes, such as the political hurdles associated with taxing the rich or local elites (Junquera-Varela, Verhoeven, Shukla, Haven and Moreno-Dodson 2017).

Figure 1 Proportion of direct tax and indirect tax in total tax revenue by decade and income group



Source: Author's calculations, using the ICTD/UNU-WIDER Government Revenue Dataset (2017).
Note: low = low-income countries; middle = middle-income countries; Malawi = Malawi; high = high-income countries; and OECD = OECD.

Figure 1 shows that in low- and middle-income countries, on average, direct tax collection averaged approximately 30 per cent of total tax revenue between 1980 and 2015. By contrast, in Malawi, the contribution of direct taxes to total revenue was 40 per cent in the 1980s, increasing to 48 per cent in 1990, before declining to 44 per cent during the 2000s. The level of direct tax collection in Malawi is well above that of low- and middle-income countries but slightly below that of high-income and OECD countries, which collect a little over 50 per cent of their tax revenue from direct taxes.

The high reliance on direct tax in Malawi is also evident when only countries in SSA are considered. Based on the ICTD/UNU-WIDER (2017) revenue dataset, the average proportion of direct tax to total revenue between 1980-2015 for countries in SSA was 24 per cent. South Africa had the highest proportion of direct taxes in total revenue (49 per cent), followed by Zimbabwe (47 per cent), Malawi (44 per cent), and Zambia (37 per cent). It was expected that South Africa would have a high proportion of direct tax collection in total revenue as it is classified as an upper-middle-income country by the World Bank,[4] based on gross national income (GNI) per capita. However, Malawi and Zimbabwe are classified as low-income countries, and Zambia is classified as lower-middle-income country. Therefore, it would be expected that these three countries would collect much more tax revenue from indirect taxes or non-taxes than from direct taxes, as is the case now.

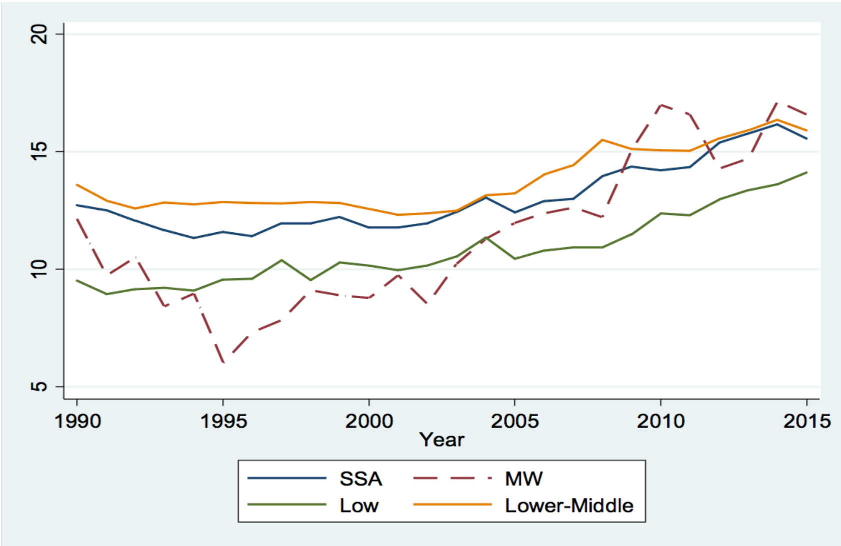
1.2 Tax-to-GDP ratio

The tax-to-GDP ratio in many regions, including low-income countries, lower-middle-income countries, and countries in SSA, has been increasing since the 1990s (IMF 2011; Keen and

[4] See World Bank Country and Lending Groups, https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups

Mansour 2010). However, from a comparative perspective, the increase in tax-to-GDP ratio in Malawi since 2009 has been above average for SSA, low-income and lower-middle-income countries (Figure 2).

Figure 2 Tax-to-GDP ratio in low-income countries, lower-middle-income countries, SSA, and Malawi (1990-2015)



Source: Author's calculation using the ICTD/UNU-WIDER government revenue dataset 2017.
Note: SSA = Sub-Saharan Africa; low = low-income countries; lower-middle = lower-middle-income countries; MW = Malawi.

Figure 2 shows that, prior to 1992, Malawi's tax-to-GDP ratio was slightly higher than the average for low-income countries but below the average for lower-middle-income countries, and SSA countries. Malawi's tax-to-GDP ratio declined in the early 1990s, and by 1993 it had decreased to below the average for low-income, lower-middle-income and SSA countries. However, the tax-to-GDP ratio began to increase in 1996. By 2005, it surpassed the average for low-income countries. In 2009, Malawi's tax-to-GDP ratio was higher than the averages for SSA, low-income countries, and lower-middle-income countries. Thus, in recent years, Malawi's tax revenue collection performance has been better than most countries in SSA, and better than low- and lower-middle-income countries.

In an attempt to find the reasons why Malawi has a high reliance on direct tax and why its tax-to-GDP ratio has been better than in most SSA countries, this study focuses on analysing the behaviour (performance) of the MRA.

2 Assessing tax administration performance in low-income countries

Bird, Martinez-Vazquez and Torgler (2008) suggest that achieving revenue adequacy is partly the result of good tax design, and largely a matter of building strong tax administrations. To measure the strength of a tax administration, several tools to assess revenue administration performance have been developed. However, these tools were either developed for use in high-income countries such as the European Union (EU) fiscal blueprint,[5] or the OECD's 'Principles of Good Tax Administration',[6] or they were less comprehensive such as:

1. The public expenditure and finance accountability (PEFA). Using PEFA, a tax administration is assessed on the following aspects: the aggregate revenue outturn, which captures only negative variations and measures forecasting accuracy but does not indicate reasons why forecasts might be inaccurate; clarity and comprehensiveness of legislation and procedures; taxpayer access to information, and existence and functioning of an appeal mechanism; taxpayer registration, penalties for non-registration and non-filing, and planning and monitoring for audits and investigations; and arrears and the collection ratio, the effectiveness of transfers to the treasury, and the frequency of reconciliations.
2. The OECD's comparative information series which covers: institutional and organisational arrangements for tax administration operations; a description of management practices; a comparison of the tax filing and payment obligations for the major taxes (PIT, CIT and VAT); a summary of selected administrative powers given to revenue bodies to carry out their mandate; and comparison of country tax burdens.
3. The International Survey on Revenue Administration (ISORA). ISORA is an extension of the OECD comparative information series. It is a survey collecting tax administration data from national or federal tax administrations. It surveys tax administration operations and other characteristics based on common questions and definitions agreed by four partner organisations: the Inter-American Center of Tax Administrations (CIAT), the IMF, the Intra-European Organisation of Tax Administrations (IOTA), and the OECD. The survey collects information in three areas of tax administration: (1) performance-related data, (2) profile data, and (3) data on administrative and operational practices. A country's participation in this survey is voluntary. One key limitation of ISORA is that it uses an online data collection platform. No verification of the accuracy of the information provided is conducted.

Until 2015, little valuable information was available on tax administration performance in low-income countries, and even less scholarly attention was paid to how tax systems actually worked in low-income countries (Bird 2015). However, the pioneering efforts of the TADAT Secretariat to collect comparative information about tax administrations in low-income countries has brought positive change (Adam Smith International 2018), and recent empirical studies on tax administration process performance in low-income countries are already drawing on this new database (Moore and Wilson 2017; Bogere 2018). As the most comprehensive tool currently being used to assess tax administration performance in low-income countries, this review of tax administration performance will focus on TADAT.

2.1 TADAT overview

TADAT is a standardised approach to diagnosing tax administration performance that pinpoints the relative strengths and weaknesses of a country's tax administration (TADAT Secretariat 2019). TADAT focuses on nine key performance outcome areas (POAs), which cover most of the functions, processes, and institutions of tax administration (Figure 3).

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[5] See European Communities (2007) *Fiscal Blueprints. A Path to a Robust, Modern and Efficient Tax Administration,* Luxembourg: Office for Official Publications of the European Communities, https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/common/publications/info_docs/taxation/fiscal_blueprint_en.pdf

[6] See OECD Committee of Fiscal Affairs Forum on Strategic Management (2001*) Principles of Good Tax Administration – Practice Note,* Centre for Tax Policy and Administration Tax Guidance Series, General Administrative Principles – GAP001, http://www.oecd.org/ctp/administration/1907918.pdf

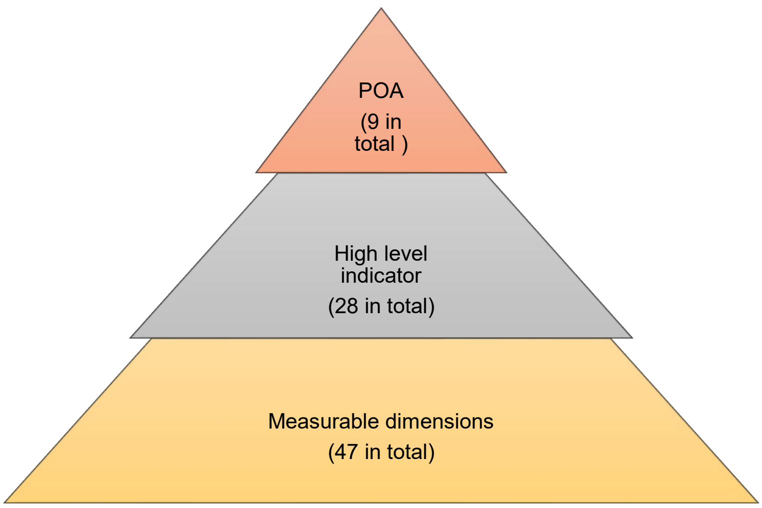
Figure 3 TADAT performance outcome areas

Source: TADAT Secretariat 2019, p.8.

As shown in Figure 3, the nine POAs are: integrity of the registered taxpayer base, effective risk management, supporting voluntary compliance, timely filing of tax declarations, timely payment of taxes, accurate reporting in declarations, effective tax dispute resolution, efficient revenue management, and accountability and transparency.

The TADAT framework has a hierarchical, pyramid-style format (Figure 4).

Figure 4 TADAT framework



Source: author's depiction of TADAT framework based on TADAT Secretariat 2019.

Figure 4 shows that at the apex of the TADAT framework are the nine POAs. Based on these outcomes, the level of maturity of a tax administration system, in the context of international good practice, is ascertained. The POAs are linked (at the second level) to 28 high-level 'indicators' that are critical to tax administration performance. The 28 indicators are then linked to 47 measurable dimensions (third level), with detailed assessment criteria, that form the basis of evaluating the performance of the system of tax administration. A four-point ABCD scale is used to score each dimension and indicator, and scores are consolidated from the dimension to the indicator level. The POAs themselves are not scored. The scoring criteria for each indicator, and the methodology used to calculate the dimension scores, are detailed in the TADAT Field Guide (TADAT Secretariat 2019, p.10), as follows:

A. Denotes performance that meets or exceeds international good practice. For TADAT purposes, good practice is taken to be a tested and proven approach applied by a majority of leading tax administrations. It should be noted, however, that a process does not need to be at the forefront of technological advancement to be considered good practice. Given the dynamic nature of tax administration, good practice – described throughout the field guide – can be expected to evolve over time, as technological advances and innovative approaches are tested and gain wider acceptance.

B. Represents sound performance (i.e. a healthy performance but below the level of international good practice).

C. Denotes weak performance, relative to good practice.

D. Denotes inadequate performance and is applied when the requirements for a C rating or higher are not met. Furthermore, a D score is given in certain situations where there is insufficient information available to assessors to determine and score the level of performance (e.g. in areas of filing, payment, and refund processing). The underlying rationale is that the inability of the tax administration to provide the required data is indicative of deficiencies in its information management system and performance monitoring practices.

2.2 Malawi TADAT assessment results

Malawi had a TADAT assessment in 2015. Although the authorities have not consented for the assessment report to be published on the TADAT website, the recently published Development Finance Assessment for Malawi (Besharati and Loga 2018) contains the results of the assessment. The results show that the MRA's performance is very poor. The MRA scored a D in 19 out of the 25 indicators on which it was assessed. This result is surprising considering that the tax-to-GDP ratio for Malawi has been increasing since the MRA started operating in 2000. Since tax administration plays a vital role in tax revenue collection performance, as argued by Bird *et al.* (2008), one would expect the increase in tax revenue in Malawi, especially that between 2005 and 2011, to be associated with good tax administration process performance. Based on the TADAT results, this does not appear to be the case for Malawi.

3 Research methodology

As indicated in the introduction, this analysis assesses the MRA's performance in four areas (taxpayer registration and data management, detection and prosecution of tax fraud, handling of administrative appeals and complaints, and provision of services and assistance to taxpayers). The analysis is based on both primary and secondary data. Primary data was collected between October 2016 and April 2017 using semi-structured interviews (17 in total) with MRA officers. From the MRA, interviews were conducted with the Commissioner General, the Commissioner for Domestic Taxes, the Deputy Commissioner for Domestic Taxes, technical staff in the Domestic Taxes Division (Technical Unit, Modernisation Unit, Large Taxpayer Unit, and Audit Unit), staff in the Policy Planning and Research Department, and staff in Taxpayer Education Services. Secondary data was obtained from the MRA's corporate plan, Acts (Taxation Act, Customs and Excise Act, and MRA Act), and MRA documents (annual reports, strategic plans). This information was used as a reference to verify whether what happens on the ground is in line with what is specified in law.

4 Findings

Overall, my findings help to explain the low overall TADAT score for Malawi as weaknesses (lack of efficiency and effectiveness) were noted in almost all departments except the Large Taxpayer Unit, where various initiatives are undertaken to mitigate shortfalls in the operation of the organisation. Below is a detailed review of the MRA in the four areas.

4.1 Tax registration and data management

Registration of taxpayers and management of the taxpayer registry underpins key administrative processes, such as filing, payment, assessment, and collection of taxes (Brondolo and Zhang 2016). Thus, one of the most important functions of any revenue administration is to identify potential taxpayers, register them, and properly manage the collected information for easy access and use.

4.1.1 Registration

Anyone operating a business in Malawi is required to register with the MRA for tax purposes, either under the standard income tax regime[7] or the turnover tax regime.[8] Businesses whose annual gross income is below MK10 million[9] (equivalent to approximately $13,516) are registered under the turnover tax regime, while those whose annual gross income exceeds MK10 million are registered under the standard scheme.[10] Taxpayers in the standard regime are further classified as either small, medium, or large.[11] A special department known as the Large Taxpayer Unit (LTU) within the Domestic Revenue Department manages large taxpayers. Initially, a business chooses the type of taxes to register for. Individuals operating a business that is not incorporated register for personal income tax (PIT) and Pay as You Earn (PAYE) for their employees. Unincorporated businesses may also register for

7 Businesses registered under the standard income tax regime are required to keep books of accounts, submit tax returns, and pay income tax at the rate of 30 per cent on profits.

8 Businesses registered under the turnover regime pay 2 per cent income tax on their gross income. They are not required to submit detailed books of accounts.

9 An exchange rate of 739 Malawi Kwacha to 1 US Dollar has been used for this and all other currency conversions in this paper. Source for exchange rate: https://www1.oanda.com/currency/converter/

10 In principle, businesses registered under the turnover tax regime are graduated to the standard regime by the MRA once their annual turnover exceeds the threshold.

11 The MRA classifies taxpayers as large, medium, and small. To qualify as a large taxpayer, either of the following conditions have to be met: a) have annual turnover of at least MK750 million (US$1.01 million), b) paying cumulative taxes (excise tax, PAYE, corporate tax, VAT, etc.) of over MK450 million (US$608,245) or above per annum, c) importing goods valued at MK750 million or above per annum, d) operating in a financial or mining sector, e) being an operator of excise tax, f) being an associated or related company whose parent company is a large taxpayer. Medium taxpayers are businesses whose annual turnover is between MK150 million (US$202,750) and MK750 million, while small taxpayers are those whose annual turnover is less than MK150 million.

withholding tax (WHT),[12] VAT, or excise tax, depending on their turnover and the type of business they undertake.[13] Incorporated businesses are registered for CIT, PAYE, WHT, and VAT. They may also register for excise tax if they are supplying excisable goods.

In 2010, the MRA embarked on a project to register as many taxpayers as possible under the turnover tax regime. A number of temporary officers were hired to identify and register potential taxpayers. The MRA database shows that taxpayers registered under the turnover tax regime make up 35 per cent of all registered taxpayers but account for just 1 per cent of total tax revenue collected by the institution. Regardless, the MRA continues to register taxpayers under the turnover tax regime.

In total, more than 70,000 taxpayers are registered with the MRA. However, in the 2015/16 fiscal year, only 32,000 were classified as active. Taxpayers classified as active are those that have filed a tax return or made a tax payment within the past three years. MRA officers have suggested that some taxpayers register with the MRA so that they receive a registration certificate and a taxpayer identification number (TIN),[14] which enables them to deal with the government and other registered traders.[15] Once taxpayers have the MRA registration certificate, most do not pay the turnover tax. The MRA does not routinely follow up with inactive registered taxpayers to determine whether they have stopped operating or they have just stopped paying taxes (one way of establishing whether taxpayers who do not file tax returns, or make any tax payment, are still economically active is by using third-party information, such as WHT receipts.[16] WHT receipts show details of taxpayers from whom the money is withheld, and the type of transaction involved).

4.1.2 Data management

A capable tax administration must deal systematically with a high volume of information. Practitioners thus regard the use of information technology (IT) as a crucial feature of successful tax administration (Berman and Tettey 2001).

Officially, the MRA uses four IT systems to manage taxpayer data for domestic taxes. However, in practice, five IT systems are in use. Below is a list of IT systems used by the MRA to manage taxpayer data:

1. The Centralised Self-Assessment System-2 (SAS2), which was introduced in 2014. This system is mainly used to generate TINs and record income tax (PAYE, CIT, WHT) payments. SAS2 is supposed to be the only system generating TINs; however, other systems (such as TACS) are also used to issue TINs.

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12 Withholding tax is an advance payment of income tax that is deducted from specified payments. The person making the payment deducts the tax. Any individual, partnership, trust, association, company, club, statutory body, council, government ministry or department, or any religious organisation, as long as it makes payments to any person, is eligible to register with the MRA and operate withholding tax. Withholding tax is deducted using specified rates. The rates are specified in the 14th Schedule to the Malawi Taxation Act.

13 Only businesses whose turnover is in excess of MK10 million are required to register for VAT.

14 Instead of using names to identify taxpayers, the MRA issues a unique number to each taxpayer on registration, called the taxpayer identification number.

15 By law, the Malawi Government deals only with suppliers that have an MRA registration certificate. Private companies, on the other hand, are not governed by similar laws. However, most registered private companies also require an MRA registration certificate to deal with them, as a social responsibility to ensure that other businesses also pay tax. The MRA further indicates that dealing with other registered taxpayers also helps a company to easily qualify for a withholding tax exemption certificate, which allows the company not to be deducted withholding tax when they supply other registered companies.

16 All registered taxpayers are required to withhold a specified percentage of money (depending on the goods or transaction being purchased) on payments made to suppliers and remit the money to the MRA. The supplier is issued with a withholding tax receipt showing the amount deducted, a copy of which is given to the MRA when the buyer is remitting the withheld money to the MRA.

2. The Tax Administration Computer System (TACS) was introduced in 1989. SAS2 was introduced as a replacement for TACS. However, the migration to SAS2 from TACS was never completed, after it was realised that some functions could not be performed in SAS2. Thus, both SAS2 and TACS are being operated, with TACS mainly used to record direct taxes (PIT, CIT, WHT). Although SAS2 and TACS perform similar functions, the two systems are not interfaced, often resulting in conflicting information. TACS, for example, has more than 67,000 taxpayers in 2016, while SAS2 has approximately 32,000 taxpayers in the same year.

3. The Centralised Self-Assessment System-1 (SAS1) was introduced in 2008 and is used to record VAT payments. It was intended to replace the Surtax Administration Computer System (SACS), which was introduced in 1989. However, some stations[17] still use SACS regularly, and the LTU uses it as a backup system.

4. SACS: as noted in point 3 above, SACS was introduced in 1989 to record surtax, a tax that was restructured in 2005 and renamed VAT. SACS is not officially recognised by the MRA, although some stations still use it.

5. Electronic Fiscal Device (EFDs): EFDs were introduced by the MRA in 2014 for the management of VAT. EFDs record VAT transactions in real time, whereas SAS1 and SACS record information from VAT returns.

All five IT systems operate individually and are not interfaced. Table 1 is a summary of the five IT systems currently being used in the MRA, and the period over which they have been operating.

Table 1 IT systems used in the administration of domestic taxes and their current status

	System	Primary function	Start date	Proposed end date	Current status
1	SAS2	Generating TINs Recording all tax payments from tax returns (CIT, PIT, WHT, VAT, excise, etc.)	2014		Active
2	EFD	Recording VAT transactions in real time	2014		Active
3	SAS1	Recording VAT returns	2008	2014	Active
4	TACS	Generating TINs Recording income tax payments (CIT, PIT, WHT) from tax returns	1989	2014	Active
5	SACS	Recording VAT returns	1989	2008	Active (informally)

Source: Interviews with MRA officers, 12-27 November 2016; TADAT (2015).

The numerous IT systems being used in the administration of domestic taxes has created a number of challenges. The following are some of the most significant:

1. Duplication of work. For example, four of the five systems are used to record VAT transactions, yet the information in the different systems is often conflicting.
2. It is difficult for the MRA to trace some activities, such as taxpayer payments, because the systems are managed by different units. For example, an officer dealing with VAT

[17] There are 28 MRA stations spread across Malawi. All the stations are supposed to use the four officially recognised IT systems. However, some stations did not phase out SACS and thus use five IT systems.

payments using the EFD or SAS1 system would require authorisation to access income tax information from SAS2. The process of getting authorisation can sometimes be rigid and complex. Officers therefore concentrate only on recording taxes under their mandate and ignore other taxes.

3. Issue of multiple TINs. In principle, each taxpayer is supposed to have one TIN, yet in practice, it has been found that a taxpayer can have more than one. During the survey of business people conducted for this study, respondents were asked if their business is registered with the MRA, and if the business has one registration certificate or multiple certificates. Three respondents out of the 450 taxpayers that were surveyed indicated that they have more than one certificate (and therefore multiple TINs) for their business. The SAS2 is programmed to only issue one TIN per taxpayer, but it is possible to override the system, thereby allowing some taxpayers to be (illegally) issued multiple TINs. There are also instances where temporary TINs are issued outside of SAS2. An officer in the audit section of the MRA indicated that some taxpayers use different TINs to circumvent payment of tax arrears or penalties when filing a return. In some cases, taxpayers use multiple TINs to file more than one tax return for the same business, breaking their gross income into smaller amounts to avoid being classified as a large taxpayer. Businesses do not want to be classified as large taxpayers, since this group is closely monitored.

All MRA departments use the five IT systems outlined above. However, in addition to using these five systems, the LTU uses a sixth system. Noting the challenge of conflicting information generated from the various IT systems, the LTU has dedicated officers to record and update taxpayer information and all their tax payments in a Microsoft (MS) Excel file.[18] This Excel file, developed and updated by LTU officers, is the MRA's most reliable and up-to-date registry for information related to taxpayers. All the details relating to a taxpayer, including their current physical address, phone numbers, and monthly tax payments by tax type, are stored in this file. However, only information and tax payments relating to taxpayers under the management of the LTU are recorded in the MS Excel file, which only accounts for 2 per cent of the total taxpayers. While the MS Excel file is thought to be the most reliable source of taxpayer information in MRA, this format and process of storing taxpayer information is not formally recognised by the MRA because Excel files present a security risk, as they can be easily manipulated.

The MRA is aware of the challenges related to their IT systems. The MRA website specifically states that:

> The functionality of the Domestic Tax Division's current transactional computer systems is limited to rudimentary registration and taxpayer accounting for assessment and payment. Most of the processes are executed in a manual environment and, consequently, the process data generated is also substantially manual. Manual processes and data present a myriad of challenges including security of data, access to the data, integrity of the data as well as extraction of the data for reporting and analysis.[19]

To resolve these problems, the MRA is in the process of procuring another system that it claims will replace the five IT systems. The new system, called the Integrated Tax Administration System (ITAS), was expected to be operational by April 2019. However, by the time of publication of this paper, the ITAS had still not been launched in Malawi.

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18 There are no dedicated officers for taxpayer data entry in the divisions that manage small and medium taxpayers. Each officer enters the information on the tax return that they are handling into the IT systems.

19 Malawi Revenue Authority (2018) 'Integrated Tax Administration System', http://www.mra.mw/help-for-taxpayers/integrated-tax-administration-system-itas

4.2 Tax audit

A tax audit occurs when the tax authority decides to closely examine a taxpayer's tax return to verify that it is accurate.[20] A tax return is normally chosen for audit when something that is entered on the return is out of the ordinary. Tax audits allow the tax authority to monitor tax revenue losses from inaccurate filing, to deter non-filing of tax returns, and to identify areas of weakness in the tax system (OECD 2010).

In terms of auditing, the key challenge for any tax authority is that it is not economically viable nor logical to audit each taxpayer. In Malawi, less than 1.5 per cent of taxpayers are audited in a year (MRA 2016). This audit rate is consistent with trends in both high-income and low-income countries, where less than 2 per cent of total taxpayers are audited in a year (Lemgruber, Masters and Cleary 2015). Large taxpayers in Malawi have a higher probability of being audited than small and medium taxpayers. On average, between 14 per cent and 33 per cent of large taxpayers are audited in a year, compared to 1 per cent of small and medium taxpayers (Table 2). Officers in the audit section of the MRA explained that they dedicate more resources to the auditing of large taxpayers because approximately 70 per cent of revenue collected by the MRA is collected from large taxpayers. During the 2014/15 fiscal year, the MRA handled a total of 252 audit cases. The distribution of the audit cases was as follows: 45 per cent comprehensive audits;[21] 48 per cent issue-oriented audits;[22] 7 per cent refund audits;[23] and 0 per cent desk audits.[24] Similar proportions of audits were conducted in the 2015/16 fiscal year (Table 2).

Table 2 Audit rates and revenues recovered in 2014/15 and 2015/16 by classification, based on turnover

Year	**2014/15**			**2015/16**		
Section	Number of taxpayers audited	Percentage of taxpayers audited	Revenue recovered (MK billion)	Number of taxpayers audited	Percentage of taxpayers audited	Revenue recovered (MK billion)
Large Taxpayer Unit	67	33%	14.6	92	14%	22.3
Medium and Small Taxpayer Units	185	1%	5.2	354	1%	4.6

Source: 2015/2016 MRA Annual Report.

The main finding from the assessment of the MRA audit function is that it is not well done. The main weakness in audit relates to case selection. To select a case for audit, the MRA is supposed to use a risk matrix. The risk matrix is a systematic way of identifying the risk of tax non-compliance among taxpayers, and is intended to help officers in the audit section target their actions to the various identified risk categories, better allocate resources across

20 A tax return is a form on which a taxpayer makes an annual statement of income and it is used by the tax authorities to assess liability for tax.

21 Comprehensive audits are generally employed when significant anomalies are detected through a desk or issue-oriented audit, or identified by the risk management system. Usually, cases selected for comprehensive audit cover all taxes for one or more tax years.

22 Issue-oriented audits are generally limited to checking particular aspects of the return and cover a single tax. For example, in the case of VAT, an issue-oriented audit may deal with all of the activities reflected in a tax return, or it may focus on one particular aspect such as turnover, exports, invoicing, or excess credit.

23 Refund audit is one form of issue audit. It has been given greater priority in recent years because of the increase in refund fraud, where taxpayers overstate the amount to be refunded (when the input VAT is greater than the output VAT, the MRA refunds the difference). Prior to 2013/14, tax refunds were usually paid without audit.

24 Desk audits include: (1) a check that the returns filed are consistent, (2) a comparative analysis of returns for different taxes, (3) a comparative analysis of the main ratios against those for similar businesses in the same sector, and (4) a cross-check against information received from other government agencies and third parties.

different types of audits (comprehensive, issue-oriented, and desk audit), and improve the overall effectiveness of the audit function. However, officers in the audit section of the MRA pointed out that the risk matrix is largely ignored. Officers just use their intuition to select cases for audit. This increases the chances of risky taxpayers being skipped. The revenue-collecting departments in MRA are aware that the audit matrix is largely ignored by the audit section. To ensure that all risky large taxpayers are audited, the LTU formulated its own risk matrix. The LTU submits the list of additional taxpayers to be audited to the audit division, and funds these additional audits using its divisional budget. The small and medium taxpayer units do not have a similar arrangement.

It was further noted that the audit system lacks a feedback mechanism. Auditors identify risks in the field, but these risks are not being collated to inform any review of risk selection criteria or compliance improvement plans. Assessment of audit reports mainly focuses on the number of audits conducted in a year, and how much money is recovered from audits. In addition, no feedback is provided by the legal division to the audit division on the outcomes of different court cases that the audit division has handed over. For instance, when officers in the audit division were asked for this study about the percentage of court cases that are ruled in favour of the MRA in a year, they could not provide any details, but referred the author to the legal division.

4.3 Dispute resolution

From time to time, disputes arise between taxpayers and the tax administrator. Disputes typically emerge as a result of an administrative error on the part of the administration or the taxpayer. In addition, the outcome of a tax audit or investigation that identifies a discrepancy may be disputed by the taxpayer on the grounds of facts (the taxpayer may have material evidence to the contrary) or legal interpretation (Lemgruber *et al.* 2015).

It is, therefore, important for a tax administration to have a systematic, fair, fast, and effective dispute resolution process. An effective tax dispute resolution process can be said to be one that is based on a legal framework, is easily accessible, guarantees transparent independent decision making, and resolves disputed matters in a timely manner (Okello 2014). Such processes typically include an independent administrative appeals process within the tax administration, and a special tribunal that taxpayers can resort to if they are dissatisfied with the outcome of the administrative appeals process (Okello 2014).

Tax dispute resolution processes that are not fair (or not seen to be fair), and/or that take a long time to resolve a dispute, may have the following consequences (UN 2017; Gangl, Hofmann and Kirchler 2015):

1. Affect taxpayers' trust in the tax administration, and the judicial system;
2. Lead some taxpayers to challenge the tax authority's integrity;
3. Lead to higher costs for taxpayers, potentially making the country unattractive for conducting business.

According to the available TADAT assessment reports, in most low-income countries, the dispute resolution process is relatively good. Out of the 14 TADAT assessment reports that are available on the TADAT Secretariat website, for the indicator P7-19 (the existence of an independent, workable, and graduated dispute resolution process), 75 per cent of the countries scored an A or B, meaning that 75 per cent of the countries have a dispute resolution process that is in accordance with international best practice.

The Malawi Taxation Act (Malawi Government 2006) (Cap 41:01, Part X, Section 95-101) and the Eighth Schedule to the Taxation Act state that when a tax dispute arises, a consensual dispute resolution process should first be attempted, in which the taxpayer makes an appeal for their case to the Commissioner General (CG). The CG, after consultation with technical staff, makes a decision. If the taxpayer is not satisfied with the CG's decision, they may appeal the decision to a special arbitrator (judges selected from the mainstream judicial system). Following the arbitrator's decision, taxpayers may appeal disputes of law to the High Court.[25] On paper, this dispute resolution process is comprehensive, providing recourse to independent arbitrators and the courts, instead of the MRA itself resolving all disputes. However, in practice, the tax dispute resolution process in Malawi does not follow all the steps outlined in the law. The majority of cases end with the MRA (i.e. they are not appealed), because most taxpayers are not aware of the dispute resolution process. During the survey conducted for this study in Malawi, business people were asked what they (or others in similar business) do if they are not satisfied with the MRA's ruling on a dispute. In total, 63 per cent answered, 'There is nothing a taxpayer can do but follow the MRA's ruling,'; 24 per cent answered, 'Settle the case as proposed by the MRA,' 7 per cent answered, 'Take the case to court or the Ministry of Finance,' and 6 per cent declined to answer. This finding suggests that the majority of taxpayers do not know that they have the option to take tax disputes to court or to a special arbitrator. It is, therefore, not surprising to note that more than 90 per cent of cases that go to court involve large taxpayers, because large taxpayers will typically have lawyers and well-qualified accountants who understand the law.

When investigating whether there are publicly available guidelines on the dispute resolution process, the author was referred by the MRA to the Taxation Act, as there are no brochures or documents that detail the appeals process for the public. Other than what is contained in the Act, there has been just one public notice (published in a newspaper in 2015) informing taxpayers that if they are not satisfied with the MRA's decision, they can refer the matter to a special arbitrator and the courts.[26] However, the notice did not provide any details on how a taxpayer could do that. Internally, the MRA has an appeals procedure document, the existence of which is only known by officers in the legal department and some auditors. Due to taxpayers' lack of awareness of the dispute resolution process, they often submit appeals to the Ministry of Finance, which usually refers the cases back to the MRA. Occasionally, the Ministry of Finance intervenes in the dispute resolution process, which adds further confusion to the process. Interviews with officers in the Ministry of Finance revealed that at least one appeal case on an MRA ruling is sent to them every month.

An interview with the Society of Accountants in Malawi on the tax appeals revealed that the institution has been asking the Ministry of Finance to establish a tax tribunal to ensure that the system is fair. In the 2018/19 budget statement,[27] the Minister of Finance announced that a tax tribunal would be introduced. However, to date, none has been set up, and there are still no public documents that provide guidance on the appeals process. Commenting on the appeals process, one taxpayer described sending a 75-page appeal letter to the MRA with receipts and other documents attached to prove that the MRA's audit conclusions were not correct. The MRA sent a one-line response, stating that, 'We maintain our earlier position.' The taxpayer was extremely disappointed with the MRA's response, as no effort was made on the MRA's part to explain why they maintained their position after being provided with additional information. Instead of involving the special arbitrator or the court, the taxpayer referred the matter to the Ministry of Finance. The taxpayer claimed that he did not know that he could refer to the case to a special arbitrator and was not comfortable asking the MRA about the process.

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25 The guiding law on appeals is the Taxation Act, Cap 41:01, Part X, Section 95-101 and Eighth Schedule. The Malawi Revenue Authority also has a document highlighting the appeals procedure.

26 Malawi Revenue Authority (2015) Tax Update – Income Tax Objection, *Daily Times*, 14 May.

27 Ministry of Finance, Economic Planning and Development (2018) 2018/19 Budget Statement, Lilongwe, Malawi http://www.manaonline.gov.mw/index.php/religion/item/9043-2018-2019-budget-%09statement-full-text

The shortage of information on the dispute resolution process mostly affects small and medium taxpayers. Almost all large taxpayers have access to specialised tax advice (including MRA officers assigned to each large taxpayer) and lawyers who are aware of the dispute resolution process.

4.4 Taxpayer education

Taxpayer education refers to programmes that aim to teach taxpayers about: their tax rights; responsibilities; legal requirements; the importance of paying tax; and what taxpayers should expect of the government, in terms of accountability (Gitaru 2017; Mascagni and Santoro 2018). To ensure voluntary tax compliance, tax administrations are expected to provide tax information and support to taxpayers so that they can meet their obligations and claim what they are legally entitled to. Tax education is also provided because very few taxpayers use the law itself as a primary source of information (Gitaru 2017). In addition, studies have shown that taxpayers often have little understanding of how tax systems work (Kira 2017; Feldman, Katuščák and Kawano 2016). Thus, advice and assistance from the tax administration plays a crucial role in bridging the knowledge gap.

The MRA disseminates tax information to the public in a number of ways, though primarily through brochures, press releases, magazine articles, radio and television slots, and content on the MRA website. The MRA also conducts seminars and workshops for taxpayers, and awareness programmes in schools. In 2018, it introduced walk-in enquiries and phone services (including WhatsApp) to address taxpayer questions. In addition, every year, the MRA publishes on its website a list of tax policy changes made by Parliament. The taxpayer education services are expansive and cover different types of taxes.

The primary limitation of the taxpayer education service provided by the MRA is that the publicly available resources and activities do not, in most cases, explain in detail the taxpayer's technical obligations and the rules that apply to them. The resources and information sessions provide basic information rather than full guidance or manuals. For instance, taxpayers are told that if they have a problem with how the MRA has handled a dispute, they can appeal to a special arbitrator. However, the advice does not contain detailed information on how to initiate the appeals process.

To ensure that large taxpayers have all the information that they need related to taxation, the LTU assigns a desk officer to each large taxpayer. The officer is a source of information on all matters relating to tax. The desk officer also ensures that he/she understands the taxpayers' business well, including how the business is performing. One taxpayer even claimed that the MRA, through the desk officers, is well conversant with what is happening with each business to the extent that the organisation is aware when the Chief Executive Officer (CEO) of a company travels outside the country. The assigning of desk officers to each taxpayer is not available to small and medium taxpayers – these are many in number, meaning it is not feasible to assign officers to each.

5 Conclusion

This paper aimed to determine the extent to which the tax administration processes followed by the Malawi Revenue Authority affect the level of tax revenue collection and the tax structure in Malawi. In general, the study finds that there are indeed significant problems in the routine functioning of the MRA which may affect tax collection. The TADAT assessment of 2015 highlights the weaknesses of the MRA and this research largely confirms it as a number of weaknesses with MRA operations have been identified. However, this analysis makes one major discovery: when judged as a whole under TADAT, the MRA's process performance appears to be poor. However, when the divisions within the MRA are considered separately, the study finds that the MRA's performance is mixed, with good performance in one of the divisions, the LTU, and weak performance in all other revenue-collecting departments. Given that the LTU is responsible for approximately 70 per cent of the domestic taxes collected by the MRA, the good tax revenue collection in Malawi can largely be attributed to the effectiveness and efficiency of the LTU in undertaking its functions. The use of MS Excel to capture complete taxpayer data, the assigning of an officer to each large taxpayer, and the frequent interactions between the LTU and the large taxpayers have contributed to the success of the LTU, which in turn has resulted in good tax revenue performance for Malawi.[28] Thus, the paper has shown that a low-income country with a pattern of tax administration that appears to be ineffective by normal measures, can be effective in practice.

These results have two broader implications. One is that performance can vary considerably between different parts of the same organisation, as is the case with the MRA, such that performance indicators intended to apply to the organisation as a whole, as is the case with TADAT, may be misleading. The other is that we still have some way to go in both understanding and measuring the factors that lead to good tax administration because even with poor TADAT scores, the MRA is still able to collect more tax revenue relative to other countries in SSA.

[28] This conclusion should not be read as a ringing endorsement of the value of LTUs, LTUs also have their problems. For a comprehensive review of LTUs and their weaknesses, refer to Terkper 2003 and Ebeke, Mansour and Rota-Graziosi 2016.

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